Finance 201: Proposal Analysis

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Overview

To provide a summary of the financial and business analysis completed during the evaluation of a developer's proposal for a housing privatization project for both Step 1 (Volume I: Qualifications) and Step 2 (Volume III – Financial)

Agenda

- Step 1 Proposal Analysis
  - Financial Statements Analysis
  - Credit References
  - Outstanding Financial and Legal Matters
  - Final Financial Rating

Agenda

- Step 2 Proposal Analysis
  - Development Budget Analysis
  - Development Sources & Uses Analysis
  - Operating Revenues & Expenditures Analysis
  - Building Component Life & Unit Cost Analysis
  - Escrow Account Analysis
  - Equity Contribution & Return Analysis
  - Construction Schedule Analysis
  - Private Debt Analysis
  - Scoring Analysis
  - RFP Requirements & Enhancements/Desired Features
  - Final Volume III Rating

Step 1 Proposal Analysis

An offeror's Step 1 proposal consists of the following parts per the latest Generic RFP (the section appearing in blue text will be the focus of this presentation):

- Volume I: Qualifications
  - Part A: Business & Financial
    - Factor 1: Business Arrangements
      - Subfactor 1.1: Team Strength
      - Subfactor 1.2: Key Personnel & Management Approach
    - **Factor 2: Financial**
      - **Subfactor 2.1: Financial Statements**
      - **Subfactor 2.2: Project Financing**
      - **Subfactor 2.3: Credit References**
  - Part B: Project Concept
    - Factor 3: Project Concept
- Volume II: Past Performance
  - Factor 4: Past Performance

Step 1 Proposal Analysis

Offerors financial capability is evaluated in three parts:

1. Financial Statements Analysis
2. Credit References
3. Outstanding Financial and Legal Matters

Step 1: Financial Statements Analysis

- Offerors submit audited financial statements for the latest 3 years for all significant parties.
- The financial statements are analyzed for 3 purposes:
  - Provide evidence of financial backing and capability to carry out the program
  - Demonstrate financial strength to develop/complete the program
  - Demonstrate possession of financial resources and access to financing sufficient both for project completion and long-term O&M of the project.

Step 1: Financial Statements Analysis (cont)

- Two sets of ratio analyses are performed by BBP in order to determine whether the offerors has met the RFP requirements
- Set 1: Offeror's Ability to Contribute the Estimated Amount of Equity
  - The first set of ratios tests the offerors' ability to contribute the estimated amount of equity
- Set 2: Overall Financial Strength
  - The second set of ratios tests the overall financial strength of the companies (personal financial statements are not included in this analysis due to the inability to compare the results to industry data)

Step 1: Financial Statements Analysis (cont)

Set 1: Offeror's Ability to Contribute the Estimated Amount of Equity

The following four ratios are performed on each equity partner:

1. Net Worth / Partner's Proposed Share of Equity (equity share x total equity contribution)
2. Net Worth / Entire equity contribution
3. Current Assets / Partner's Proposed Share of Equity (equity share x total equity contribution)
4. Current Assets / Entire equity contribution

Step 1: Financial Statements Analysis (cont)

Set 2: Overall Financial Strength

Four ratios are calculated and compared to industry averages to determine the overall financial strength:

- Total Debt / Equity
- Long-term Debt / Equity
- Current Ratio (defined as Current Assets / Current Liabilities)
- Quick Ratio (defined as Quick, or Liquid, Assets / Current Liabilities)

Step 1: Credit References

- Each offeror submits at least 3 credit references from either a lending institution/major supplier/major contractor
- Each credit reference is asked the following series of questions by BBP:

1) Have you provided credit to the offeror in the past for a $10 Million or greater residential project? If so how is it performing? If not, why have you been listed as a credit reference?
2) Are you aware of any defaults or poor performance involving the offeror?
3) How long have you been in business with the offeror? Has the offeror credit increased or decreased over time?
4) Are you aware of any current or impending litigation against the offeror?
5) Have you in the past placed any extraordinary restrictions on the financial activities of the offeror as a condition for doing business? If so, how did they perform?

Step 1: Outstanding Financial and Legal Matters

- The PSC reviews financial statements and information and Dun & Bradstreet reports for any mention of litigation, disputes, claims, UCC filings or similar circumstances which may affect the offeror's ability to finance the project

- If any of the above are discovered, each offeror is required to provide the current status of each matter in full detail

Step 1: Final Financial Rating

- BBP then recommends a rating of Highly Qualified, Qualified or Unqualified based on the results of the series of ratio analyses performed on the financial statements and information provided
- Any findings during the review of credit references or outstanding financial and legal matters are used to determine whether the ratings assigned after review of the financial statements should be adjusted downward

Step 2 Proposal Analysis

An offeror's Step 2 proposal consists of the following parts per the latest Generic RFP (the section appearing in blue text will be the focus of this presentation):

- **Volume III: Financial**
  - **Factor 1: Financial**
    - **Subfactor 1.1: Project Viability over the 50-Year Business Arrangement**
    - **Subfactor 1.2: Financial Strategy**
    - **Subfactor 1.3: Government Participation in Project Financing**
    - **Subfactor 1.4: Mechanics of Accounts**
- Volume IV: Design & Construction
- Volume V: Property Management

Step 2: Volume III Analysis

- BBP creates 14 tables in which all information found in the Volume III submissions for every offeror is dissected and organized for evaluation

Step 2: Schedule 1-- Development Budget Analysis

	Offeror A			Offeror B		
ITEM	Total ($M)	Per Unit	Per SF	Total ($M)	Per Unit	Per SF
Hard Costs - Each Neighborhood or Site						
Land Cost						
Land Development/Infrastructure						
Demolition						
Construction						
Landscaping/Recreational Amenities						
Contingency						
Total - Offeror's Proposed Off-base Site						
Hard Costs - Total						
Land Cost						
Land Development/Infrastructure						
Demolition						
Construction						
Renovation						
Landscaping/Recreational Amenities						
Contingency						
Total - Hard Costs						

Step 2: Schedule 1 -- Development Budget Analysis (cont)

What we look for in hard costs:

- Are the costs reasonable based on the project proposed?
  - RS Means is one source that is used to test for reasonableness, as well as a cost estimator that assists us in our evaluation
- Has an offeror budgeted too little or too much for a specific line item?
- Has the offeror included sufficient contingency funds to help ensure the project is completed?
- Are the contingency funds simply included in the budget or are they deposited into an account that can be drawn upon if necessary?

Step 2: Schedule 1 -- Development Budget Analysis (cont)

ITEM	Offeror A			Offeror B		
Soft Costs	**Total**	**Per Unit**	**Per SF**	**Total**	**Per Unit**	**Per SF**
Construction Period Interest						
Architect/Engineering Design Fees						
Legal and Accounting						
Insurance						
Consultant Fees:						
Payable to:						
Development Fees						
Payable to:						
Financing Transaction Fees						
Reserves						
Interest						
Other						
Contingency						
R/E Tax						
Impact Fees						
Payable to:						
Other Fees						
Payable to:						
Credit Support Costs						
Commissions						
Payable to:						
Start-up Costs						
Working Capital						
Total - Soft Costs						

Step 2: Schedule 1 -- Development Budget Analysis (cont)

What we look for in soft costs:

- Has the offeror budgeted the correct line items?
  - Some line items that are sometimes overlooked are real estate taxes and impact fees, especially if some portion of the project is not located on gov't land
- What are soft costs as a percentage of hard costs?
  - This helps to identify whether the offeror's proposed soft costs are high
- What are the proposed fees and are they reasonable?
- Has the offeror included sufficient contingencies?

Step 2: Schedule 2 -- Sources & Uses Analysis

Item	Offeror A		Offeror B	
Sources:				
	$M	%	$M	%
Excess of Revenues over Expenditures during construction period				
Developer Equity Contribution				
cash				
deferred fees or profits				
Developer Financing				
1st mortgage				
interest earned - loan escrow				
2nd mortgage				
Total Sources				
Developer				

Step 2: Schedule 2 -- Sources & Uses Analysis (cont)

Item	Offeror A		Offeror B	
Uses:	**$M**	**%**	**$M**	**%**
Pre-Development Costs				
Land Aquistion Costs				
Land Development Costs				
Demolition Costs				
Hard Construction Costs				
Soft Construction Costs				
Financing Costs construction period interest				
Debt Service				
Other/Contingency				
Total Uses				
Total Sources in Excess of Total Uses	$0.0		$0.0	

Step 2: Schedule 2 -- Sources & Uses Analysis (cont)

What we look for in sources & uses:

- Are sources equal to or greater than uses? (You'd be surprised to know some offerors have failed this test!)
- Has the offeror maximized use of net operating income as a source of funds in order to minimize private debt?
- Has the offeror contributed at least the minimum amount of equity as required by the RFP?
- Does the developer defer fees? Under what conditions?
- Has the offeror maximized use of all private funds in order to minimize government contribution and risk?
- Can all uses be identified in the development budget and vice versa?

Step 2: Schedule 3 -- Operating Revenues & Expenditures Analysis

	Offeror A		Offeror B	
GENERAL DATA				
Total Units				
BAH Inflator				
Expense Inflator				
Property Tax Inflator				
RENTAL REVENUE				
BAH				
Utility Allowance				
Gross Potential Rent				
Vacancy Allowance				
Other Income				
Total Rental Revenue				
PROPERTY OPERATING EXPENDITURES	**% of BAH**	**% of total expenses**	**% of BAH**	**% of total expenses**
Administrative Expenditures				
Marketing Expenditures				
Professional Fees				
Utilities				
Personnel Costs				
Contract Services				
Cleaning & Decorating				
Repairs & Maintenance				
Taxes & Insurance				
Total Operating Expenditures				
Excess of Operating Revenues Over Expenditures	0.0%		0.0%	

Step 2: Schedule 3 -- Operating Revenues & Expenditures Analysis (cont)

What we look for in Operating Revenues & Expenditures:

- Are all assumptions reasonable?
- How does the starting vacancy rate assumed in the pro forma compare to the current base demographics included in the RFP?
- Is the assumed BAH and expense inflation rate reasonable? Is one inflated faster than the other?
- Are any expenses too high/too low?
- Are the proposed fees reasonable?

Step 2: Schedules 4 & 5 -- Building Component Life & Unit Cost Analysis

Building Component	Offeror A			Offeror B		
	Estimated Life	Unit of Measure	Unit Cost (Base Year)	Estimated Life	Unit of Measure	Unit Cost (Base Year)
Carpeting						
Floor Covering						
Roofing						
HVAC System						
Water Heater						
Appliances (specify)						
Refrigerator						
Range						
Dishwasher						
Garbage Disposal						
Exterior Painting						
Utility & Structural System						
Landscaping						
Recreational Areas						
Other						
Whole House Renovation						

Step 2: Schedules 4 & 5 -- Building Component Life & Unit Cost Analysis (cont)

What we look for in Building Component Life & Unit Costs:

- Are all assumptions reasonable?
  - A cost estimating firm that is a subcontractor to us will perform this function
- Does the schedule of replacement included in the pro forma match the estimated life stated by the offeror?

Step 2: Schedule 6 -- Escrow Account Analysis

Developer	NPV (5.1%) of Unit Investments	NPV per unit	Total	Average
Offeror A				
ACCOUNT ACTIVITY				
Replacement Reserve Account				
Beginning Balance	$0	$0	$0	#DIV/0!
Interest Proceeds	$0	$0	$0	#DIV/0!
Deposits	$0	$0	$0	#DIV/0!
Withdrawals	$0	$0	$0	#DIV/0!
Ending Balance	$0	$0	$0	#DIV/0!
Reinvestment Account				
Beginning Balance	$0	$0	$0	#DIV/0!
Interest Proceeds	$0	$0	$0	#DIV/0!
Deposits	$0	$0	$0	#DIV/0!
Subtotal	$0	$0	$0	#DIV/0!
Withdrawals	$0	$0	$0	#DIV/0!
Ending Balance	$0	$0	$0	#DIV/0!
Offeror B				
ACCOUNT ACTIVITY				
Replacement Reserve Account				
Beginning Balance	$0	$0	$0	#DIV/0!
Interest Proceeds	$0	$0	$0	#DIV/0!
Deposits	$0	$0	$0	#DIV/0!
Withdrawals	$0	$0	$0	#DIV/0!
Ending Balance	$0	$0	$0	#DIV/0!
Reinvestment Account				
Beginning Balance	$0	$0	$0	#DIV/0!
Interest Proceeds	$0	$0	$0	#DIV/0!
Deposits	$0	$0	$0	#DIV/0!
Subtotal	$0	$0	$0	#DIV/0!
Withdrawals	$0	$0	$0	#DIV/0!
Ending Balance	$0	$0	$0	#DIV/0!

Step 2: Schedule 6 -- Escrow Account Analysis (cont)

What we look for in the Escrow Account Analysis :

- Is enough money deposited into the accounts to cover the proposed expenditures?
- When are deposits made (before or after debt service and/or preferred return)?
- If interest is earned, is the interest rate reasonable?
- Is money left in the accounts each year after expenditures to provide for a cushion every year?
- What is the net present value of the expenditures on the units?

Step 2: Schedule 7 -- Equity Contribution & Return Analysis

Developer	10-Year IRR Calculation	50-Year IRR Calculation
Offeror A Equity Contributed Expected Return		
Offeror B Equity Contributed Expected Return		

Step 2: Schedule 7 -- Equity Contribution & Return Analysis (cont)

What we look for in the Equity Contribution & Returns:

- Is the developer's return reasonable?
  - A developer will typically look for a Before-Tax return of 15% to 20%
- What is the AF/Developer split of net cash flow?
- Is the AF split conditioned on the developer first receiving a preferred return?

Step 2: Schedule 8 -- Construction Schedule Analysis

	Year:	1	2	3	4
		2004	2005	2006	2007
Offeror A					
Units Demolished					
Units Constructed					
Units Renovated					
Cumulative Units Completed					
Cumulative Percent Complete		#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
Offeror B					
Units Demolished					
Units Constructed					
Units Renovated					
Cumulative Units Completed					
Cumulative Percent Complete		#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!

Step 2: Schedule 8 -- Construction Schedule Analysis (cont)

What we look for in the Construction Schedule:

- Is the timing for demolition, renovation and construction reasonable and does it meet the RFP requirements?
- Is the construction schedule back-end loaded (a majority of the construction does not occur until the end of the time period allowed by the RFP)
- Does the construction schedule match the flow of funds in each year during construction?
- Are sources sufficient to cover uses in each year, not just overall?

Step 2: Schedule 9 -- Private Debt Analysis

Item	Offeror A	Offeror B
Construction: Type Amount Interest Rate (as base +spread) Interest Rate (est.) Term DCR Points & Fees		
Permanent Type Amount Interest Rate (as base +spread) Interest Rate (est.) Term DCR Points & Fees		
Additional Features		
AF Guarantee %		

Step 2: Schedule 9 -- Private Debt Analysis (cont)

What we look for in the private debt analysis:

- What type of debt has been proposed (conventional loan or bond)?
- Are the points and fees required by the lender reasonable?
- Is the lender's commitment letter firm or conditional?
- If conditional, are those conditions reasonable?
- Is the debt secured at transaction closing or some point in the future?
- Is the interest rate reasonable?
- Has the risk of interest rate fluctuation both before and after closing been mitigated?

Step 2: Schedule 10 -- Scoring Analysis

Private First Mortgage	**Offeror A**	**Offeror B**
Loan Amount :		
Year Required :		
Loan Type :		
Percent Guaranteed :		
Amortization Period (Years) :		
Points:		
Interest Rate :		
Deferral Periods (Years) :		
Interest Rate During Deferral :		
Interest Paid During Deferral :		
Interest Subsidy Rate :		
Default Subsidy Rate :		
Other Subsidy Rate :		
Total Subsidy Rate :		
Private Mortgage Scoring :		

Step 2: Schedule 10 -- Scoring Analysis (cont)

Direct Loan	Offeror A	Offeror B
Loan Amount :		
Year Required :		
Loan Type :		
Percent Guaranteed :		
Amortization Period (Years) :		
Interest Rate :		
Deferral Periods (Years) :		
Interest Rate During Deferral:		
Interest Paid During Deferral:		
Interest Subsidy Rate :		
Default Subsidy Rate :		
Other Subsidy Rate :		
Total Subsidv Rate :		
Direct Loan Scoring :		
Total Government Investments & Payments		
1. Differential Lease Payments :	$ -	$ -
2. Occupancy Guaranty :	$ -	$ -
3. Provisions of Goods & Services :	$ -	$ -
4. Direct Investment :	$ -	$ -
Total Invest & Paymts Scoring :	$ -	$ -
Total Scoring Amount:	**$0**	**$0**

Step 2: Schedule 10 -- Scoring Analysis (cont)

What we look for in the scoring analysis :

- Has the scoring included in the offeror's proposal been calculated correctly?
- Does the proposed scoring violate any RFP or legislative requirements?
- Has the Air Force's scored cost been minimized?

Step 2: Schedules 11 – 14 -- RFP Requirements & Enhancements/Desired Features

- Every RFP requirement, enhancement and evaluation factor from Sections 4 and 5 of the RFP are put into the remaining 4 tables
- The requirements/enhancements from the RFP are listed down the left-hand column in the tables
- The tables are then filled in for each offeror to show where in their proposal they have met, not met, or exceeded a RFP requirement

Step 2: Final Volume III Rating

- All of the information from the 14 schedules can then be used by the PSC to develop strengths and weaknesses for each offeror by subfactor

- The strengths and weaknesses are then used by the AST to assign color ratings for each offeror by subfactor

Finance 201: Proposal Analysis

Questions?